No. 35 — November-December 1960

Business in Brief

issued bi-monthly by the Economic Research Department

THE CHASE MANHATTAN BANK

18 Pine Street, New York 15, N. Y.

The stability in industrial production through July has been followed by a moderate decline. At the same time, the inevitable uncertainties as to the new Administration's policies becloud the outlook.

Nevertheless, the basic factors favoring the long-term advance in the economy remain strong. The general impact of the economic adjustments underway has been quite moderate thus far. With continued underlying confidence on the part of consumers and business, it is possible that the adjustments which appear to lie ahead could be made with a minimum of difficulty.

•

Thus, the new Administration will be faced with an opportunity to generate a renewed period of economic advance. To do so, it must pursue policies which maintain confidence at home and abroad and provide a solid basis for genuine economic growth.

It is, to be sure, impossible to tell at the moment precisely what programs of an economic character the Kennedy Administration will embrace. But, in view of the tremendous responsibilities the nation confronts, it is to be hoped that the policies adopted will build on America's vast strength by maintaining the integrity of the dollar and encouraging the increase in investment necessary for substantial economic progress.

•

Most of the significant business indicators have moved moderately downward since July:

¶ **Gross national product** in constant dollars dropped from an annual rate of $505 billion in the second quarter to $501.6 billion in the third, a decline of seven-tenths of one percent.

¶ The index of **industrial production** is off from 110 in July to 107 in October. Output of both durable and nondurable goods has turned down.

¶ The **unemployment rate,** seasonally adjusted, rose from 4.8% in February to 6.4% in October, while employment has been on the decline since June.

¶ **Housing starts** have been well below last year. The Commerce Department estimate for 1960 as a whole has been scaled down to 1,250,000 units — almost one-fifth below the near-record 1959 level.

At the same time, several favorable signs are in view.

¶ The **money supply** has been increasing since May. The greater availability of funds at lower interest rates can help moderate the over-all adjustment and provide the basis for a subsequent revival of business activity.

¶ **Government purchases** of goods and services are rising. New orders for defense items more than offset declines in private orders for durable goods in August and September.

¶ **Retail sales** picked up in October, in part because of a vigorous sell-off of 1960 model cars. Yet this strength at retail can be an important sustaining force in a period of inventory adjustment.

¶ Very preliminary signs point to the possibility that the adjustment in **business expenditures for new plant and equipment** could be more moderate than in earlier postwar periods. The lack of excess in expanding capacity in 1959 and 1960 could prove to be a favorable factor in 1961.

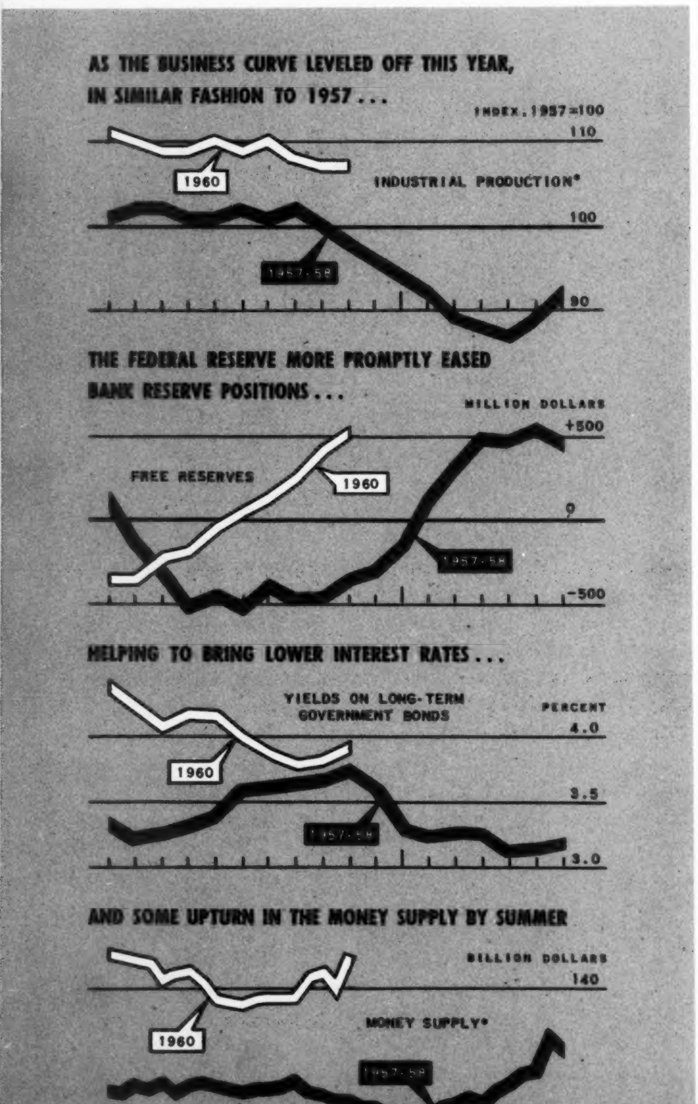
All in all, prospects for keeping the adjustment in general business moderate and promoting an upturn in 1961 appear favorable, assuming continuation of a positive outlook regarding the future. Thus, in the present situation it is important to remove the uncertainties which always surround a change in the national administration. Prompt action by President-elect Kennedy to develop and announce programs that will contribute to prosperity and growth, while maintaining price stability, would go far towards assuring confidence.

OUTPUT OF DURABLE AND NONDURABLE GOODS IS DECLINING

MONETARY POLICY, THE TREND OF BUSINESS, AND THE BALANCE OF PAYMENTS

Our continuing balance of payments deficit and the related uneasiness over the international position of the dollar have required a thoroughgoing review of many aspects of American economic policy. The President's recent directive to cut back on some types of military spending abroad and to curb the outflow of dollars stemming from certain foreign aid programs is one dramatic illustration of the wide ramifications of this problem. And, that directive is also a symbol of the determination of the Government to maintain the integrity of the dollar.

Less publicized, but equally important, is the delicate and difficult task of the monetary authorities in balancing domestic aims against these balance of payments considerations. On the one hand, moves towards easier money have clearly been justified as a means of paving the way for a renewed advance in business activity. But these easier money policies appropriate to the domestic scene, by stimulating a sizable outflow of short-term funds, have at the same time helped aggravate our payments deficit vis-a-vis other countries.



In broad outline, the response of the monetary authorities this year to signs of an easing in business at home has followed the pattern set during other postwar periods of business adjustment. If anything, 1960 has been notable for the speed with which the Federal Reserve has acted to bolster the domestic economy.

Thus, as early as February and March, when evidence first developed that a widely heralded boom might fail to materialize, measures were taken to relax the strong pressures on the banking system and the money market. In subsequent months, amid growing uncertainty over the business outlook, more aggressive actions to ease credit followed. These moves have contributed to a pronounced change towards greater ease in the monetary and credit environment.

Dollars Flowing Abroad

The difficulty is that these same easier money policies have had other, and disturbing, consequences for our balance of payments position and the international position of the dollar. With interest rates sharply reduced at home, a large volume of short-term capital has flowed abroad in search of the higher yields available in foreign markets. While data are incomplete and not entirely adequate (many of these transactions are not recorded in the official statistics), current indications are that as much as a billion dollars of this type of "hot money" may have left the country during the third quarter alone. That figure for a single quarter would be several times the volume reached during any previous full year since World War II.

This increased flow of funds into foreign hands has been matched in part by a willingness of some countries to continue to build up their dollar balances in this country – itself a sign that confidence in the dollar is still basically strong. But others, reflecting long-standing practices, have chosen to use their additional dollars largely to purchase gold from the U. S. – gold that the Treasury makes freely available to foreign monetary authorities at $35 an ounce. As a result, the decline in our gold stock – one measure of our international financial position – has accelerated. During the past five months, this country has lost over $1¼ billion of gold, reducing our gold stock to its lowest point in 20 years.

Futher complicating the situation has been concern in some quarters that inflationary pressures – while now

latent – might be permitted to reassert themselves. Fears of this type, even if unfounded, can act to undermine confidence in the ability of this country to rectify its current payments imbalance. The recent willingness of private speculators to bid the price of gold on the London market to levels well above the American selling price is one signal of the existing uneasiness. With the effective operation of the international payments mechanism so heavily dependent on maintenance of confidence in the dollar, warnings of this character cannot be lightly dismissed.

Recent Moves

Recognition of the problems posed by these developments is implicit in recent actions of the monetary authorities both in this country and abroad. Most notably, leading European central banks have reduced their discount rates – a move apparently designed to reduce the interest rate incentive to shift funds to those countries.

In addition, the pattern of recent Federal Reserve actions strongly suggests that it is seeking operational techniques that will tend to minimize, if not entirely eliminate, the conflict between the immediate domestic objectives and balance of payments considerations.

- The discount rate has been held at 3% since August, despite the downward tilt in business since then. Moreover, member bank reserve positions, while not under any general pressure since the summer, have not been further eased in the last few weeks despite some intermittent tightness in the central money market. Both of these factors have helped limit the downward pressures on the short-term rate structure.

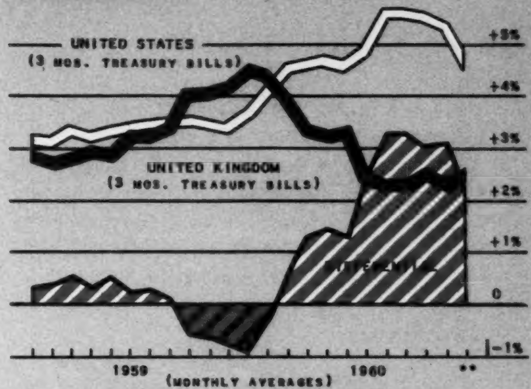
- As a means of releasing reserves to meet seasonal needs towards the year-end, the Federal Reserve has chosen to change member bank reserve requirements rather than to engage in large-scale open-market purchases. The latter alternative might have had a more concentrated and pronounced effect on the rates of short-term securities.

- For only the third time since 1952, the Federal Reserve has purchased securities other than Treasury bills during the course of its open market operations. While all purchases have been confined to the short-term area, diversion of some buying from the bill market into other securities (which were at least temporarily in ample supply) minimized the effect of these purchases on the bill rate itself – the key rate with respect to short-term capital flows.

Underlying Strength

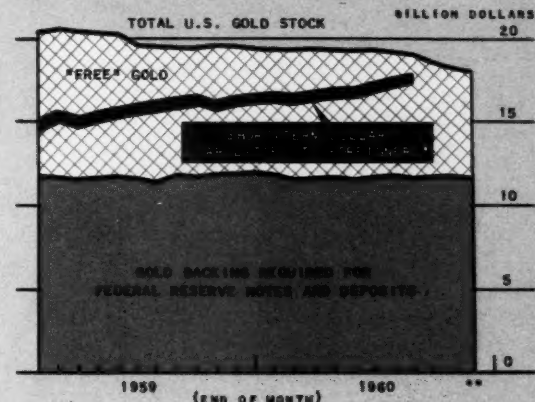
In assessing the current situation, it is important that sight not be lost of the underlying strength of the dollar. Thus, short-term capital movements aside, steady and significant progress has been made this year in balancing our international accounts. That has been largely a reflection of a surge in exports.

SHORT-TERM INTEREST RATE DIFFERENTIALS BETWEEN THE U.S. AND LEADING EUROPEAN COUNTRIES WIDENED THIS YEAR . . .



NOTE: DIFFERENTIAL MAY BE NARROWED BY COSTS ASSOCIATED WITH INVESTING ABROAD

RESULTING CAPITAL OUTFLOW IS REFLECTED IN LOSS OF GOLD AND RISING FOREIGN DOLLAR BALANCES



*EXCLUSIVE OF INTERNATIONAL INSTITUTIONS

**LATEST AVAILABLE FIGURES

DATA: FEDERAL RESERVE BOARD

Perhaps even more significant, the President's action to reduce Government spending abroad should not only help close the payments gap directly by roughly $1 billion per year, but should also serve as a forceful reply to those who have feared that the U.S. was unwilling or unable to take what measures might be necessary to defend the dollar. Moreover, there have been encouraging signs that other countries are now prepared to share more of the financial burden of foreign aid.

These factors of strength could prove much more significant in the end than the disturbing effects of "hot money" movements – volatile by their nature and subject to quick reversal. With the United States still holding almost 45% of the free world's gold, the country is still in a solid position for withstanding speculative pressures. Against this background, a conclusion that capital outflows compel a complete reversal of recent monetary policies – at the expense of hampering the chances for an early and vigorous business advance – would seem premature.

INVENTORY ADJUSTMENT

The economy is in the midst of another inventory adjustment. Business has shifted from adding to inventories at an annual rate of $11 billion in the first quarter to liquidating inventories at a rate of perhaps $3 billion in the current quarter. This $14 billion about-turn led to a reduction, first in new orders, and then in sales and production, over a broad range of industries. Thus, the inventory adjustment was an important factor in the slow-down in industrial output in recent months.

Two Features

The current inventory adjustment has two impelling forces. One is related to the typical movements in inventory buying associated with the business cycle. The other reflects the efforts of business to economize on inventories by operating with lower inventory-sales ratios throughout the cycle.

The long-term trend towards lower inventory-sales ratios was interrupted in the early postwar period. With prices rising and many goods in short supply, there was every incentive to build up inventories.

However, the atmosphere has changed, particularly since the end of the 1959 steel strike. Industrial prices have been stable. Supplies of most products have been readily available. Thus, there is less incentive to build up stocks and, in fact, an incentive to cut them to reduce costs.

At the same time, business has been working to perfect new methods of inventory control. In some cases, the use of electronic computers has permitted savings by reducing the number of each size, color or model that must be kept on the shelf to meet incoming orders.

Meanwhile, certain countervailing forces are at work. In some cases, particularly in autos and other consumer durables, the proliferation of models, types and colors increases inventory requirements. Then, too, there is an attempt to push inventories back on suppliers, so lower inventories at retail may be offset in part by higher stocks at the manufacturing level.

Recent Experience

How have these diverse forces been operating? There is a clear contrast between experience in durable and nondurable goods. Inventories of durable goods in manufacturing and trade are as high now in relation to sales as they were at comparable stages of previous postwar inventory cycles.

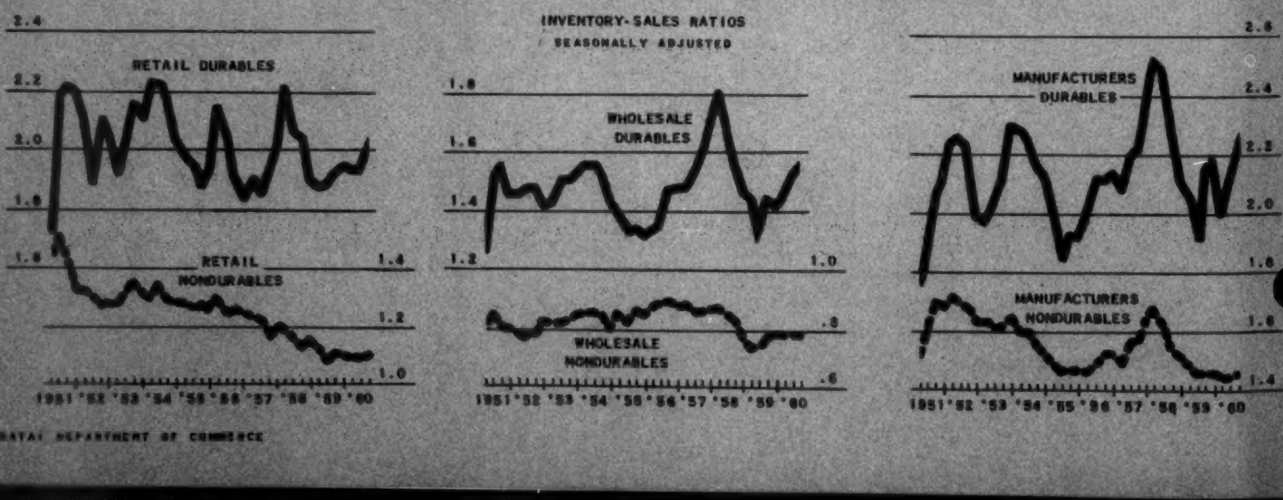
However, the composition of durable inventories has been shifting. Stocks of raw materials have been cut back. Steel inventories are being worked down to extremely low levels. In contrast, finished goods inventories have gone up about $1 billion this year. Part of this increase may be involuntary in the sense that goods backed up because sales were disappointing.

All of this would suggest that the inventory adjustment in durable goods could run on for a further period. The main emphasis will be on working down stocks of finished goods. But some further adjustment in raw materials and purchased parts may also result as business attempts to operate with lower inventories.

In nondurable goods establishments, there is definite evidence of a decline in the inventory-sales ratio. At the retail level, this decline appears to be more than a current period phenomenon. Here the ratio of inventories to sales has declined from about 1.4 in 1951 to 1.1 in 1960. The decline in inventories has been general throughout the major categories of retail business. It has been particularly steep in the retail apparel business, where the ratio has dropped from 3.3 in 1954 to 2.4 in recent months. Changes in methods of merchandising, materials handling, and generally improved management control may have been important factors affecting inventory savings in the retail business.

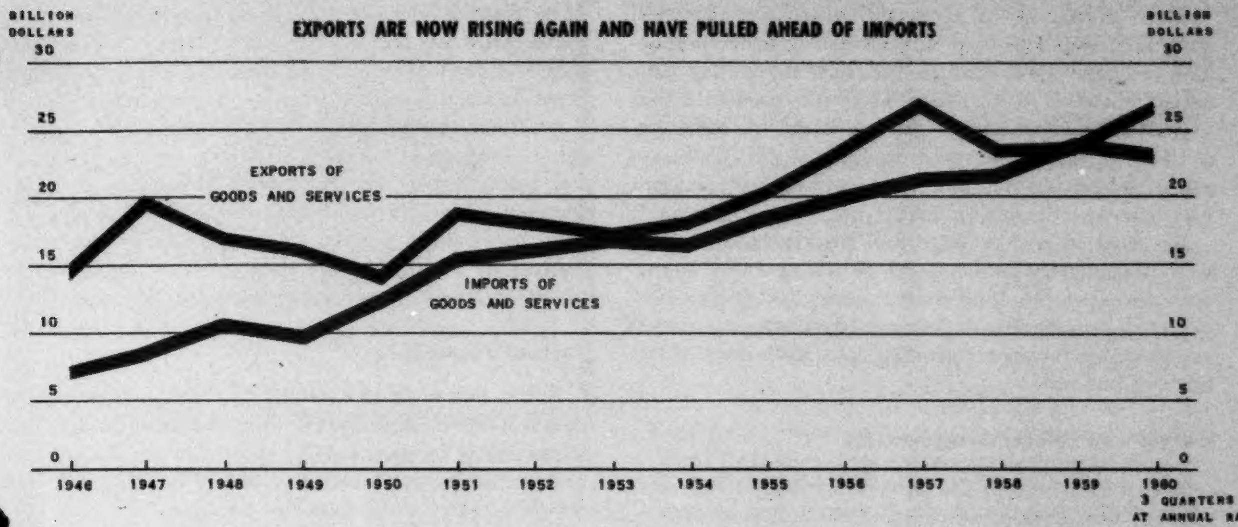
In the long run, attempts to economize on inventories would appear to be all to the good. Savings in this area can be put to more productive and profitable use in supporting technical advance and in modernizing our productive machine.

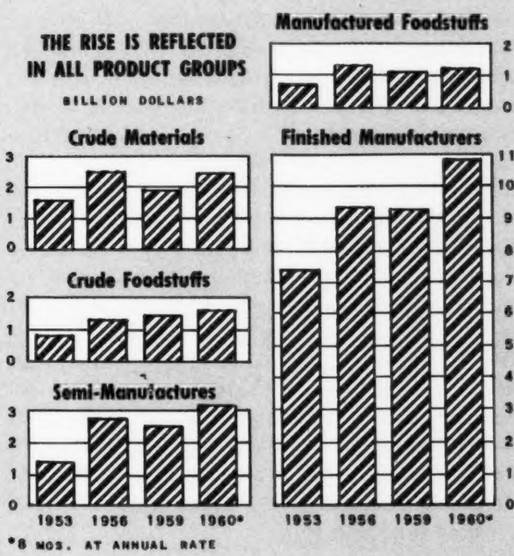
DURABLE GOODS INVENTORY-SALES RATIOS FOLLOW CYCLICAL PATTERN, WHILE NONDURABLE GOODS RATIOS SHOW EVIDENCE OF LONG-TERM DECLINE

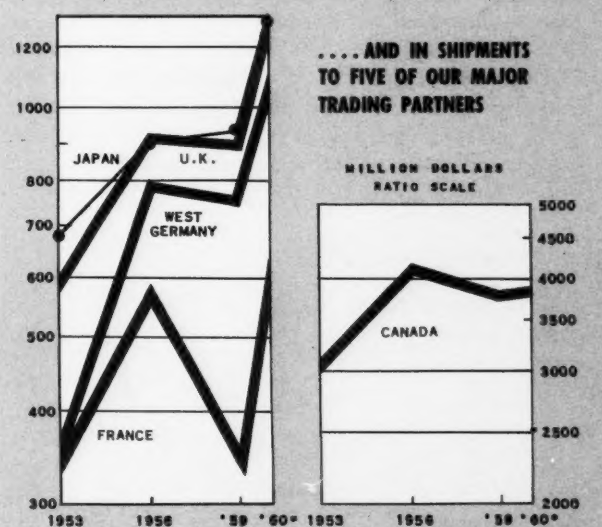


DATA: DEPARTMENT OF COMMERCE

U. S. BALANCE OF PAYMENTS







THE BALANCE OF PAYMENTS ON CURRENT ACCOUNT IMPROVED SUBSTANTIALLY THIS YEAR BUT THE OUTFLOW OF SHORT-TERM CAPITAL ROSE

	1951-1957 Average	1959	Estimate 3rd Qtr. 1960 Annual Rate
	millions of dollars		billions of dollars
The U.S. takes in from exports of goods & services	$20,322	$23,464	$28.0
We pay out for commercial imports of goods & services	15,006	20,470	20.5
Leaving a balance on current commercial account of	5,316	2,994	7.5
Against this balance must be set:			
Net outflow of short-term private investment	250	89	2.0
Net outflow of long-term private investment	1,503	1,664	1.6
Military expenditures abroad	2,466	3,090	2.8
Government grants	2,085	1,839	1.8
Government loans and credits	371	358	.8
Private remittances	465	563	.6
Unrecorded transactions	—475	—783	1.3
Or a total outflow of public and private capital:	6,277	6,820	10.9
Yielding a deficit on international payments accounts of	961	3,826	3.4

DATA: DEPARTMENT OF COMMERCE AND THE CHASE MANHATTAN BANK

INVENTORY ADJUSTMENT

The economy is in the midst of another inventory adjustment. Business has shifted from adding to inventories at an annual rate of $11 billion in the first quarter to liquidating inventories at a rate of perhaps $3 billion in the current quarter. This $14 billion about-turn led to a reduction, first in new orders, and then in sales and production, over a broad range of industries. Thus, the inventory adjustment was an important factor in the slow-down in industrial output in recent months.

Two Features

The current inventory adjustment has two impelling forces. One is related to the typical movements in inventory buying associated with the business cycle. The other reflects the efforts of business to economize on inventories by operating with lower inventory-sales ratios throughout the cycle.

The long-term trend towards lower inventory-sales ratios was interrupted in the early postwar period. With prices rising and many goods in short supply, there was every incentive to build up inventories.

However, the atmosphere has changed, particularly since the end of the 1959 steel strike. Industrial prices have been stable. Supplies of most products have been readily available. Thus, there is less incentive to build up stocks and, in fact, an incentive to cut them to reduce costs.

At the same time, business has been working to perfect new methods of inventory control. In some cases, the use of electronic computers has permitted savings by reducing the number of each size, color or model that must be kept on the shelf to meet incoming orders.

Meanwhile, certain countervailing forces are at work. In some cases, particularly in autos and other consumer durables, the proliferation of models, types and colors increases inventory requirements. Then, too, there is an attempt to push inventories back on suppliers, so lower inventories at retail may be offset in part by higher stocks at the manufacturing level.

Recent Experience

How have these diverse forces been operating? There is a clear contrast between experience in durable and nondurable goods. Inventories of durable goods in manufacturing and trade are as high now in relation to sales as they were at comparable stages of previous postwar inventory cycles.

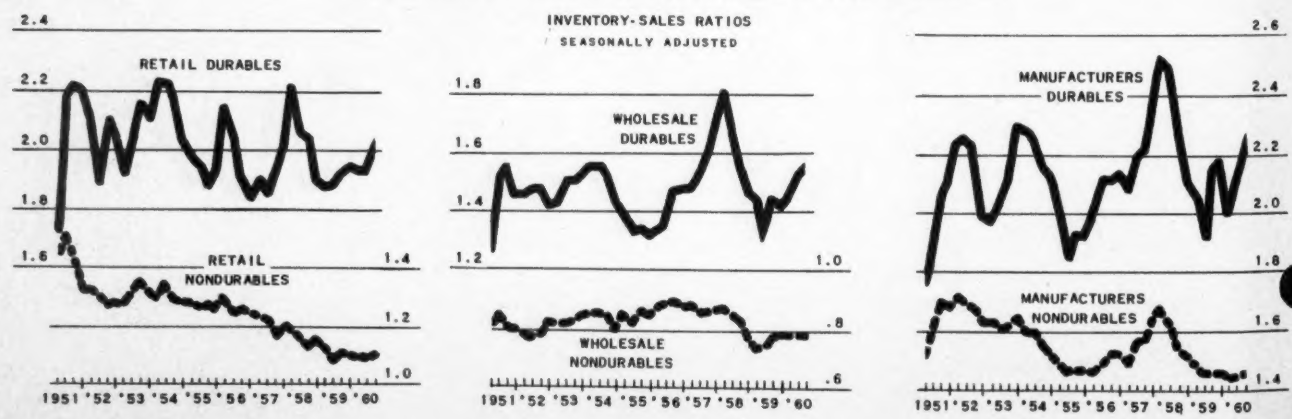
However, the composition of durable inventories has been shifting. Stocks of raw materials have been cut back. Steel inventories are being worked down to extremely low levels. In contrast, finished goods inventories have gone up about $1 billion this year. Part of this increase may be involuntary in the sense that goods backed up because sales were disappointing.

All of this would suggest that the inventory adjustment in durable goods could run on for a further period. The main emphasis will be on working down stocks of finished goods. But some further adjustment in raw materials and purchased parts may also result as business attempts to operate with lower inventories.

In nondurable goods establishments, there is definite evidence of a decline in the inventory-sales ratio. At the retail level, this decline appears to be more than a current period phenomenon. Here the ratio of inventories to sales has declined from about 1.4 in 1951 to 1.1 in 1960. The decline in inventories has been general throughout the major categories of retail business. It has been particularly steep in the retail apparel business, where the ratio has dropped from 3.3 in 1954 to 2.4 in recent months. Changes in methods of merchandising, materials handling, and generally improved management control may have been important factors affecting inventory savings in the retail business.

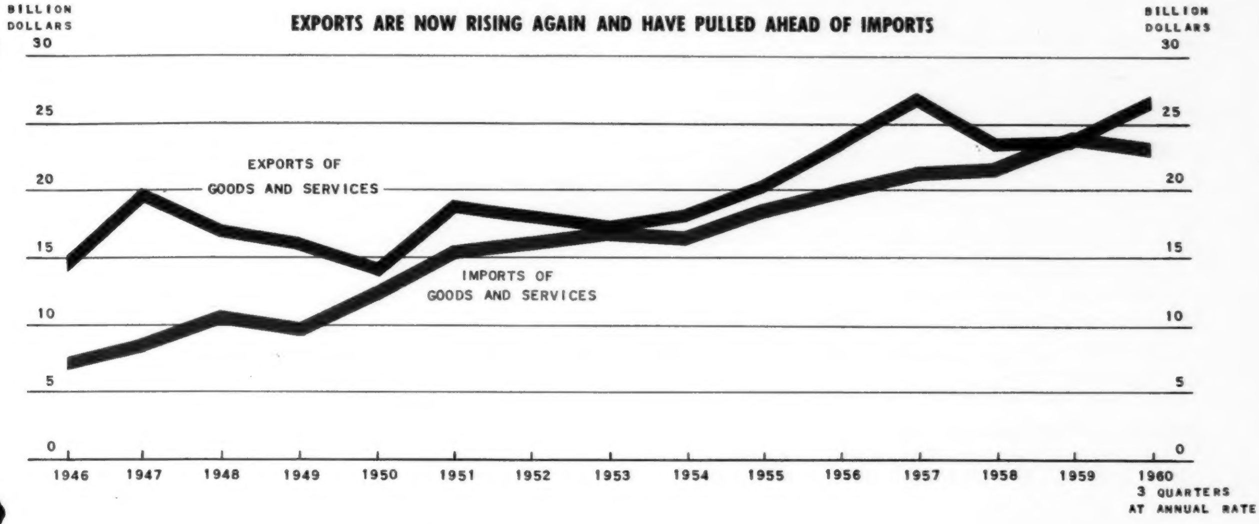
In the long run, attempts to economize on inventories would appear to be all to the good. Savings in this area can be put to more productive and profitable use in supporting technical advance and in modernizing our productive machine.

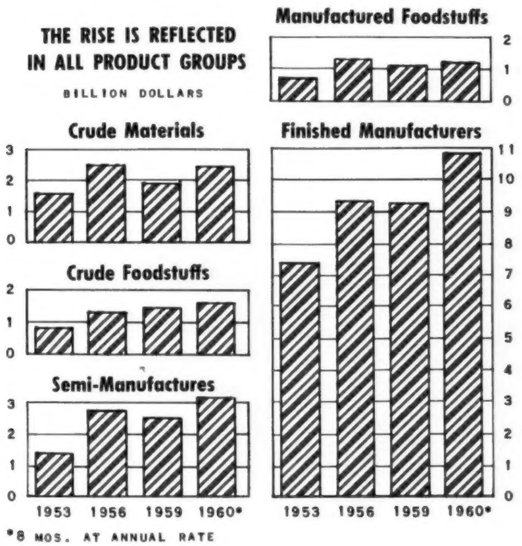
DURABLE GOODS INVENTORY-SALES RATIOS FOLLOW CYCLICAL PATTERN, WHILE NONDURABLE GOODS RATIOS SHOW EVIDENCE OF LONG-TERM DECLINE

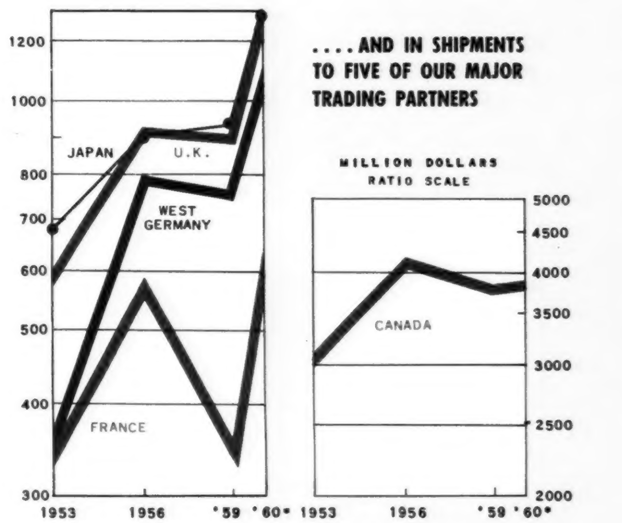


DATA: DEPARTMENT OF COMMERCE

U.S. BALANCE OF PAYMENTS







THE BALANCE OF PAYMENTS ON CURRENT ACCOUNT IMPROVED SUBSTANTIALLY THIS YEAR BUT THE OUTFLOW OF SHORT-TERM CAPITAL ROSE

	1951-1957 Average	1959	Estimate 3rd Qtr. 1960 Annual Rate
	millions of dollars		billions of dollars
The U.S. takes in from exports of goods & services	$20,322	$23,464	$28.0
We pay out for commercial imports of goods & services	15,006	20,470	20.5
Leaving a balance on current commercial account of	5,316	2,994	7.5
Against this balance must be set:			
Net outflow of short-term private investment	250	89	2.0
Net outflow of long-term private investment	1,503	1,664	1.6
Military expenditures abroad	2,466	3,090	2.8
Government grants	2,085	1,839	1.8
Government loans and credits	371	358	.8
Private remittances	465	563	.6
Unrecorded transactions	–475	–783	1.3
Or a total outflow of public and private capital:	6,277	6,820	10.9
Yielding a deficit on international payments accounts of	961	3,826	3.4

DATA: DEPARTMENT OF COMMERCE AND THE CHASE MANHATTAN BANK

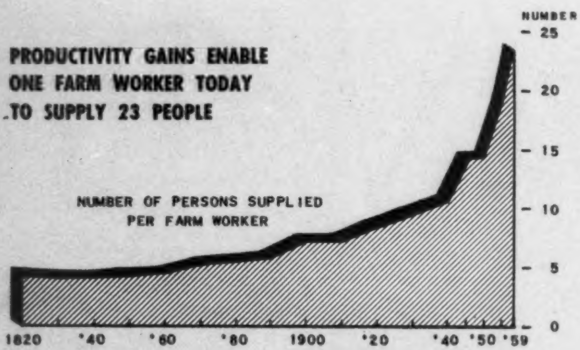
PERSPECTIVE ON THE FARMING BUSINESS

Farm output is up again this year. For the third time in a row, both crop harvests and livestock production are high. Cash receipts from farm marketings have edged ahead of a year ago, and with production expenses not much changed, the net income of farm proprietors is running at an annual rate of $11.4 billion – slightly above last year and equal to advance Agriculture Department estimates for 1961.

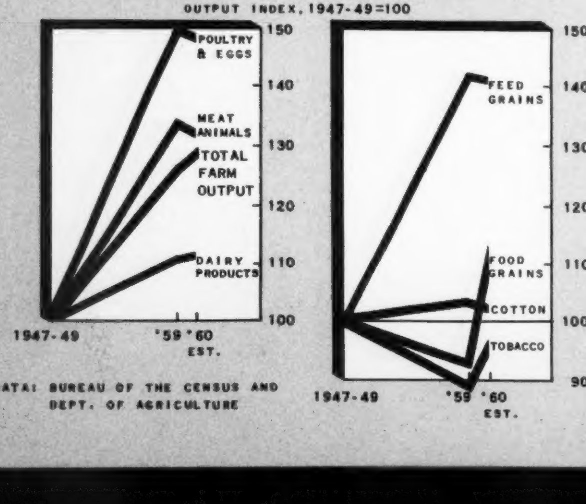
As usual in such a large and diverse industry, this over-all summary results from crosscurrents in output and prices of the farm sector's many products. Also involved are significant long-run developments which are changing, at an accelerating rate, the nature of the farming business.

Output and Prices: Crosscurrents

First, let's look briefly at the short-term picture. The rise in output this year is due to record crop harvests – 2.4% larger than last year. Production of food grains and tobacco increased substantially while vegetables and feed grains held even, and cotton output decreased slightly. The wheat crop is especially large – one-fifth above its 1959 size. Crop prices, on balance, held up to the previous year's level in the first nine months of this year, despite the fact that price supports for some basic commodities are lower.



OUTPUT HAS RISEN ALMOST 30% IN THE POSTWAR PERIOD; HIGH PROTEIN FOODS ARE UP THE MOST



DATA: BUREAU OF THE CENSUS AND DEPT. OF AGRICULTURE

In livestock, the effects of basic production and price cycles show up clearly. The cattle population is large, and beef production is up substantially. Prices, therefore, have declined, and the drop has been sufficient to pull down total receipts. The hog cycle is in the opposite stage. Production has been curtailed, and the price rise has been sizable. Hog-corn price ratios now favor an increase in production. Dairy output and prices are both up slightly; poultry and egg receipts have risen. Striking an average for all livestock, then, production is about the same as last year, but prices are down somewhat.

Further Abundance

Rising output is one of the key components of the long-run farm picture. Farm production increased 28% in the 1950's for an average rate of 2.5% per year. That's as rapid as the war-induced growth of the 1940's and far above the rates of the previous decades.

It is also above the growth in demand for farm products. In the 1950's, population increased at a rate of 1.8% per year – 30% slower than the gain in output. And although food spending rose with incomes, farmers gained little as more went for the built-in-service of food preparation and packaging. The farmers' share of the food dollar was cut from 47¢ to 38¢ in the decade.

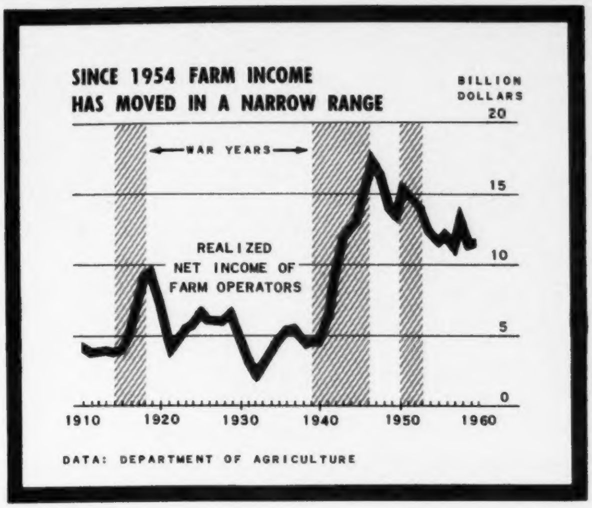
Demand for farm products for textiles and export has also lagged, although in each case some speed-up has taken place recently. Cotton has improved its competitive position vis-a-vis man-made fibers as new finishes have been developed. Exports of farm commodities have risen, partly with the help of the Federal government.

Over-all, however, the growth in demand has not succeeded in keeping pace with the increased production of the nation's farms. An estimated 8% of output in recent years has gone into Government storage. A total of $9 billion of basic crops are stockpiled in Government warehouses. And the average price of farm commodities has settled at a lower level.

The Productivity Paradox

These rising surpluses and lower prices have influenced many farmers to switch to nonfarm occupations. One million farm people move into the towns and cities every three years. Manhours worked on farms have declined 30% since 1950. Crop land planted has been cut back 5% in the last ten years, and the number of breeding livestock has held stable.

However, there has been a phenomenal increase in productivity. Output per manhour worked has gone up more than 6% per year over the past decade. Yield per acre is up 30% and meat production per animal has risen 20%. Even in a situation of farm surpluses it pays the individual farmer to step up his output and productivity as rapidly as possible.



Agribusiness

This huge rise in productivity constitutes a revolution in farming. It is associated with the rise of agribusiness – highly productive commercial farming using relatively large amounts of machinery and equipment and following advanced farming techniques.

These developments result from a massive research effort over several decades. The Federal government has poured over $2 billion into farm research since 1950. State governments and universities have played a part, and so has private industry. Here are some of the aspects of the revolution wrought by research:

- **Machinery** on farms has increased steadily. The number of tractors is up 40% in a decade and use of specialized equipment has multiplied rapidly.

- **Materials handling** methods, borrowed from other industries, have had a great impact on the farm. Such operations as harvesting and livestock feeding are now thought of partly as materials handling problems.

- **Chemical** use has increased sharply – 50% more plant nutrients are applied than in 1950. Fertilizer is tailored for particular crops and localities; antibiotics are used to combat diseases in plants and animals; growth regulators, akin to hormones, are used to ripen whole fields uniformly at desired times.

- **Business management** knowledge is helping the farmer. Lower prices for his output coupled with rising prices for the things he must buy have resulted in widespread study of the intricacies of cost analysis.

Structure of Farming

What have these new developments meant for the farmer? The answer has depended on the location, financial situation and skill of the individual. Those who have been successful tended to fit into one of three patterns:

- Some farmers have enlarged their farms by purchasing the land of their neighbors who moved into nonfarm jobs. These larger farms required heavy capitalization, but were able to use specialized machinery and complicated techniques efficiently. Thus, 80% of all farm commodities marketed are now produced on the 27% of all farms with sales of over $5,000.

- Some farmers have succeeded with the help of vertical integration. The often quoted example is the poultry farmer who gets his chicks, feed, financing and advice from a feed company which then negotiates the sale of his chickens. The Department of Agriculture estimates that 95% of all broilers are produced under some form of vertical integration and that 90% of all vegetables produced for canning and freezing are grown under contract.

- Finally, there are some farmers who have been freed from farm duties by mechanization and efficiency so as to take part- or full-time jobs in town. More than one-third of the income of farm families now comes from nonfarm sources.

Thus, the farm community has evolved into two groups and the farm problem into two parts. There are the relatively less efficient farmers who have not made the adjustment to the cost-price squeeze and whose income is low. The basic problem here is to improve their lot either by enabling them to become more productive as farmers or by assisting them to shift into a nonfarm activity. Price supports are not much help since such farms produce little for sale.

The other group consists of the agribusinesses which can produce more than can be sold at current prices. The problem is to bring over-all supplies of farm products more closely into line with demand, while assuring farmers and consumers an equitable share in increased efficiency. A challenge to the nation is to work out farm programs that will contribute to this objective.